IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

BRIDGEPORT ETHANOL, L.L.C., Taxpayer/Appellant, vs. NEBRASKA DEPARTMENT OF REVENUE, a Nebraska Administrative Agency, and DOUGLAS EWALD, in his capacity as the State Tax Commissioner for the State of Nebraska, Defendants/Appellees.	CASE NO. CI11-1363 **ORDER**

INTRODUCTION

THIS MATTER came before the court on July 1, 2011, for hearing on the Notice of Appeal and Complaint for Reversal of Decision of Nebraska Department of Revenue filed by Appellant Bridgeport Ethanol, L.L.C. ["Bridgeport"]. Attorney William E. Peters appeared on behalf of Bridgeport. Assistant Attorney General L. Jay Bartel appeared on behalf of Appellees the Nebraska Department of Revenue [the "Department"] and Douglas Ewald, State Tax Commissioner [the "Tax Commissioner"]. Hearing was held and evidence adduced. The matter was argued and submitted. The court, being duly advised, finds and orders as follows:

PROCEDURAL BACKGROUND

This is an appeal pursuant to NEB. REV. STAT. §§ 77-2708(2)(f), 77-27,127 (Reissue 2009) and 84-917 (Cum. Supp. 2010) from a final decision of the Department and Tax Commissioner denying a claim for refund of sales and use taxes filed by Bridgeport in the amount of $1,602,182.34. Bridgeport sought a refund of $1,570,294.22 in sales and use taxes paid by the contractor on building materials and equipment used in the construction of Bridgeport's ethanol plant. The remainder of the claim ($31,888.12) was based on sales taxes paid by Bridgeport for various software and equipment which Bridgeport asserted qualified for exemption as purchases of manufacturing machinery and equipment. The Tax Commissioner denied the entire amount of the refund sought based on sales and use taxes paid by the contractor, as the contractor, not Bridgeport, was the purchaser and consumer of the materials and equipment, and Bridgeport was thus not entitled to claim a refund of taxes paid by the contractor. The Tax Commissioner allowed a partial refund in the amount of $6,324.84 of sales taxes paid by Bridgeport as the purchaser of qualified manufacturing machinery and equipment, determining that the remainder of its purchases did not qualify for exemption. Bridgeport timely appealed the Tax Commissioner's decision.

FACTS

A. Construction of Bridgeport's Ethanol Plant.

On June 14, 2007, Bridgeport entered into an agreement with ICM, Inc. ["ICM"] for the design and construction of a dry mill fuel-grade ethanol plant to be located near Bridgeport, Nebraska. Under the agreement, ICM was obligated to complete all work in connection with the project, including "such engineering, labor, materials, and

equipment [required] to design, construct, startup and achieve guaranteed performance criteria of a dry mill ethanol plant. . . ." The total contract price for completion of all project work was $67,450,000. The General Conditions of the contract included a provision that "[t]he Contract Price includes all sales and use taxes applicable to the Project," and an agreement that Bridgeport "for all purposes has paid for such taxes under the terms and conditions of the Contract Documents after [Bridgeport] has made payments to [ICM]." The General Conditions further stated it was "also understood by the Parties that [Bridgeport] shall be entitled to all reimbursements, credits, allocation or set-offs (hereinafter, "Tax Credits") for the payment of said taxes from any municipal, county, state or federal agency." It was estimated that the sales and use taxes for the project would be approximately $2,100,000.

B. Sales and Use Tax Treatment of Contractors and ICM's Option 3 Contractor Election.

For sales and use tax purposes, a "contractor or repairperson" is defined as "any person who performs any repair services upon property annexed to, or who annexes building materials to, real estate, including leased property, and who, as a necessary and incidental part of performing such services, annexes building materials to the real estate being so repaired or annexed or arranges for such annexation." NEB. REV. STAT. § 77-2710.10 (2009). This section further provides:

> The contractor or repairperson:
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> (1) Shall be permitted to make an election that he or she will be taxed as a retailer in which case he or she shall not be considered the final consumer of building materials annexed to real estate;
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> (2) Shall be permitted to make an election that he or she will be taxed as the consumer of building materials annexed to real estate, will pay the sales tax

or remit the use tax at the time of purchase, and will maintain a tax-paid inventory; or

(3) Shall be permitted to make an election that he or she will be taxed as the consumer of building materials annexed to real estate and may issue a resale certificate when purchasing building materials that will be annexed to real estate. Such person shall then remit the appropriate use tax on any building materials when withdrawn from inventory for the purpose of being annexed to real estate at the rate in effect at the time and place of the withdrawal from inventory.

NEB. REV. STAT. § 77-2701.10(1) to (3) (Reissue 2009).

Under the Department's sales and use tax regulations pertaining to contractors, the contractor election in § 77-2701.10(1) is referred to as an "Option 1 contractor", defined as "a contractor who has elected to be taxed as a retailer or a contractor who has not made an election." 316 N.A.C. § 1.017.02J (2009). The contractor election in § 77-2701.10(2) is referred to as an "Option 2 contractor", defined as "a contractor who has elected to be taxed as the consumer of building materials with a tax-paid inventory." 316 N.A.C. § 1.017.02K. The contractor election in § 77-2701.10(3) is referred to as an "Option 3 contractor", defined as "a contractor who has elected to be taxed as a consumer of building materials with a tax-free inventory." 316 N.A.C. § 1.017.02L.

"Option 1 contractors are retailers of those building materials that become annexed." 316 N.A.C. § 1.017.05A. "Option 1 contractors must collect sales tax from all of their customers . . . on the total amount charged for building materials they annex to real estate . . . ." 316 N.A.C. § 1.017.05C(1). "Option 1 contractors will not collect sales tax on qualifying manufacturing machinery and equipment sold to a manufacturer regardless of whether the equipment remains tangible personal property or is annexed." 316 N.A.C. § 1.017.05F.

"Option 2 contractors are consumers of those building materials that become

annexed." 316 N.A.C. § 1.017.06A. "Option 2 contractors must pay the sales tax on all building materials and other taxable items when purchased or received." 316 N.A.C. § 1.017.06C(2). "Option 2 contractors must pay sales or use tax on all manufacturing machinery and equipment and any related repair or replacement parts they purchase and annex for a customer." 316 N.A.C. § 1.017.06F(1). "Option 2 contractors cannot purchase such items without paying tax even if they have a Nebraska Resale or Exempt Sale Certificate, Form 13, or a Purchasing Agency Appointment and Delegation of Authority for Sales and Use Tax, Form 17, from a manufacturer." 316 N.A.C. § 1.017.06F(1)(a).

"Option 3 contractors are consumers of those building materials that become annexed." 316 N.A.C. § 1.017.07A. "Option 3 contractors must pay the use tax directly to the Department of Revenue on all building materials when the building materials are removed from inventory or when received at the job site." 316 N.A.C. § 1.017.07C(2)(a). "Option 3 contractors must pay use tax on all manufacturing machinery and equipment and any related repair or replacement parts they purchase and annex for a customer." 316 N.A.C. § 1.017.07F(1). "Option 3 contractors must pay use tax on such items even if they have a Nebraska Resale or Exempt Sale Certificate, Form 13, or a Purchasing Agency Appointment and Delegation of Authority for Sales and Use Tax, Form 17, from a manufacturer." 316 N.A.C. § 1.017.07F(1)(a).

ICM elected to be an Option 3 contractor. As an Option 3 contractor, ICM opted "to maintain a tax-free inventory of those building materials intended to be annexed to real estate. . .", and agreed to "remit consumer's use tax at the rate in effect at the time and place those materials [were] withdrawn from [its] inventory." "Option 3 contractors

[also] must pay use tax on all manufacturing machinery and equipment and any related repair or replacement parts they purchase and annex for a customer." 316 N.A.C. § 1.017.07F(1).

C. Bridgeport's Sales and Use Tax Refund Claim.

On September 23, 2010, Bridgeport filed a Claim for Overpayment of Sales and Use Tax, Form 7, seeking a refund of sales tax in the total amount of $1,602,182.34. The stated basis for the claim was "for sales tax reimbursements on manufacturing equipment purchased by Bridgeport Ethanol to be used in their manufacturing facility." Of the total amount claimed, $1,570,294.22 was based on sales and use taxes paid by ICM, the construction contractor for the Bridgeport ethanol plant. The remainder of the claim ($31,888.12) was based on sales tax paid by Bridgeport. Tax statements for the beginning of the project commencing April 2007 through February 2009 show the amount of sales and use taxes paid by ICM on its purchase and use of various items, which are also reflected on vendor invoices for these transactions.[1] Separate tax statements for the period from January 2008 through December 2008 show the amount of sales taxes paid by Bridgeport, which are reflected on vendor invoices for those transactions involving direct purchases by Bridgeport of these items.

D. The Tax Commissioner's Partial Denial of Bridgeport's Refund Claim.

By letter dated March 3, 2011, the Tax Commissioner approved in part

[1] While Bridgeport sought a refund for the total amount of sales and use taxes paid by ICM, the tax statements contain a column titled "Owner's Mfg M & E Exemption" which includes notations for "Y" and "N", presumably indicating "Yes" and "No", indicating that not all of these transactions ostensibly applied to the purchase of manufacturing machinery and equipment or parts used to assemble manufacturing machinery and equipment.

Bridgeport's refund claim. The Tax Commissioner noted that Bridgeport's claim requested a refund of sales and use taxes paid by the contractor on building materials and machinery or equipment furnished during construction of the ethanol plant, as well as sales tax paid by Bridgeport on purchases of various supplies and equipment. With respect to the claim for refund of sales and use taxes paid by the contractor, the Tax Commissioner noted that, pursuant to NEB. REV. STAT. § 77-2708(2)(a) (2009), "tax erroneously collected can only be refunded to the purchaser." With regard to the exemption for manufacturing machinery and equipment in NEB. REV. STAT. §§ 77-2701.47 and 77-2704.22 (2009), the Tax Commissioner noted that "this exemption is limited to purchases made directly by a manufacturer." Thus, "the claim was reviewed to determine the amount of sales and use tax Bridgeport, as a manufacturer, paid on qualified manufacturing machinery and equipment."

The Tax Commissioner concluded that the portion of the claim consisting of sales and use taxes paid by the contractor on building materials and equipment totaling $1,570,294.11 was not eligible for refund, as the contractor, not Bridgeport, was the purchaser.[2] With respect to the remainder of the claim ($33,888.12) based on sales tax paid by Bridgeport on purchases of various pieces of software and equipment, the Tax Commissioner approved a refund of $6,324.84. The Tax Commissioner denied the remaining sales tax associated with this portion of the refund claim ($25,563,28),

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[2] The Tax Commissioner inadvertently referred to ICM as an "Option 2" contractor required to pay sales or use tax at the time of its purchase of building materials or equipment. In actuality, ICM is an "Option 3" contractor, required to pay use tax on all building materials and equipment when withdrawn from inventory. Such mistake does not affect the Tax Commissioner's denial, as in either case, ICM was the purchaser and consumer of the building materials and equipment and thus was the person obligated to pay sales or use tax.

because it was determined, based on the information provided by Bridgeport, that the software and other equipment was not primarily used to:

- guide, control, operate, or measure the manufacturing process;
- produce, fabricate, assemble, process, finish, refine, or package the products produced; or
- maintain the integrity of the product, transport, convey, handle, or store the raw materials or products produced, or to measure the quality of the finished product.

Further, the Tax Commissioner disapproved the claim for refund of "tax paid on the purchase of consumable supplies, hand tools, and lab supplies. . .", as "[s]uch items do not qualify for the manufacturing machinery and equipment exemption even though such items are expended during the manufacturing process."

Bridgeport filed an appeal of the Tax Commissioner's determination on April 1, 2011.

STANDARD OF REVIEW

The Tax Commissioner's action on a sales or use tax refund claim "shall be final unless the taxpayer seeks review of the Tax Commissioner's determination as provided in section 77-27,127." NEB. REV. STAT. § 77-2708(2)(f). "Any final action of the Tax Commissioner may be appealed, and the appeal shall be in accordance with the Administrative Procedure Act." NEB. REV. STAT. § 77-27,127 (2009). "The appeal provided by [§ 77-27,127] shall be the exclusive remedy available to any taxpayer . . . ." *Id.* Pursuant to the Administrative Procedure Act, the Court reviews the Commissioner's final decision "without a jury de novo on the record of the agency." NEB. REV. STAT. § 84-917(5)(a) (Cum. Supp. 2010). In conducting such review, "a

rebuttable presumption of validity attaches to the actions of" the Tax Commissioner, *Norwest Corp. v. Dep't of Ins.,* 253 Neb. 574, 583, 571 N.W.2d 628, 634 (1997), and "[t]he burden of proof rests with the party challenging the [Tax Commissioner's] action." *Dillard Dep't Stores, Inc. v. Polinsky,* 247 Neb. 821, 825, 530 N.W.2d 637, 641 (1995).

ANALYSIS

I. THE TAX COMMISSIONER'S DENIAL OF BRIDGEPORT'S CLAIM FOR REFUND OF SALES AND USE TAXES PAID BY ICM.

Bridgeport sought a refund of $1,570,294.22 in sales and use taxes paid by ICM on building materials and equipment used in the construction of its ethanol plant. Bridgeport asserts it is entitled to a refund of sales and use taxes paid by ICM for manufacturing machinery and equipment installed at its ethanol plant. In support of its claim, Bridgeport advances two arguments. First, it asserts that the provision in its contract with ICM stating the contract price included all sales and use taxes applicable to the project, and that Bridgeport would be entitled to claim any tax credits, should be recognized as a valid "purchasing agent appointment." Second, Bridgeport argues the Tax Commissioner erroneously determined that, because ICM was an Option 3 contractor required to pay sales or use tax on all building materials and manufacturing machinery and equipment purchased and annexed at the plant, Bridgeport was not the purchaser or user of such property and thus was not eligible to claim the manufacturing machinery and equipment exemption. Bridgeport asserts that this interpretation is contrary to the intent of the manufacturing machinery and equipment exemption. The court finds each of Bridgeport's claims are incorrect.

A. No Statutory Authority Exists For Bridgeport to Have Appointed ICM as its "Purchasing Agent".

Nebraska's sales and use tax statutes authorize only certain exempt organizations or entities to appoint a contractor as a "purchasing agent" to permit the purchase of building materials tax-free. Qualifying nonprofit religious, service, educational, or medical organizations are authorized to appoint purchasing agents "for the purpose of altering the status of the construction contractor as the ultimate consumer of building materials which are physically annexed to the structure and which subsequently belong to the owner of the organization or institution." NEB. REV. STAT. § 77-2704.12(3) (Reissue 2009). The State, schools, or selected governmental units are also granted the authority to appoint purchasing agents for this purpose. NEB. REV. STAT. § 77-2704.15(2) (2009). "The appointment must be made by using a Purchasing Agent Appointment and Delegation of Authority for Sales and Use Tax, Form 17." 316 N.A.C. § 1.017.08C(3). In addition, some tax incentive programs also allow refunds of sales and use taxes on tangible personal property, materials incorporated into real estate, or improvements to real estate made after the appointment of a contractor or repairperson as purchasing agent. NEB. REV. STAT. §§ 77-4105(3)(a)(iv) and 77-4106(2)(c) (2009) (Nebraska Employment and Investment Growth Act); NEB. REV. STAT. § 77-5725(2)(a)(iii)-(v) (Cum. Sup. 2010) (Nebraska Advantage Act).[3]

"[T]ax exemption provisions are to be strictly construed, and their operation will not be extended by construction." *Metropolitan Utilities Dist. v. Balka,* 252 Neb. 172, 176, 560 N.W.2d 795, 799 (1997). One claiming an exemption from taxation must

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[3] In addition, while not based on a purchasing agent appointment, the Nebraska Advantage Rural Development Act allows use of a tax credit to obtain a refund of sales and use taxes which are "deemed to have been paid indirectly . . . by a contractor on building materials annexed to an improvement to real estate built for the taxpayer." NEB. REV. STAT. § 77-27,188.01(4) (Reissue 2009).

establish entitlement to the exemption. *Omaha Public Power Dist. v. Nebraska Dep't of Revenue,* 248 Neb. 518, 520, 537 N.W.2d 312, 314 (1995).

The appointment of purchasing agents entitled to purchase building materials tax-free is limited by §§ 77-2704.12(3) and 77-2704.15(2) to nonprofit religious, service, educational, or medical organizations and the State, schools, or selected governmental units. Apart from these specific exempt organizations or entities, the general sales and use tax statutes provide no authority for the appointment of agents to purchase tangible personal property tax-free. As the Nebraska Supreme Court stated in *A & D Technical Supply Co., Inc. v. Nebraska Dep't of Revenue,* 259 Neb. 24, 31, 607 N.W.2d 857, 863-64 (2000): "[B]asic principles of statutory interpretation requires us to interpret §§ 77-2704.12(3) and 77-2704.15(2) as delimiting the circumstances under which the agent of a tax-exempt organization may assume the tax-exempt status of the principal." As Bridgeport obviously is not an exempt organization or entity authorized to issue a purchasing agent appointment under §§ 77-2704.12(3) or 77-2704.15(2), no statutory authority existed to permit Bridgeport to claim ICM acted as its appointed purchasing agent.[4]

Nor can Bridgeport establish the existence of purchasing agent authority under any of the various tax incentive program provisions allowing refunds of sales and use taxes on tangible personal property, materials incorporated into real estate, or improvements to real estate made after the appointment of a contractor as purchasing

[4] Apart from the absence of any statutory authority to permit such an appointment, the court finds that the contractual provision relied on by Bridgeport also could not constitute a proper appointment of ICM as a purchasing agent under the statutes and the Department's regulations.

agent. Each of these incentive programs requires that the taxpayer be engaged in a qualifying business, and that an agreement between the Tax Commissioner and the taxpayer be executed, in order for the taxpayer to be eligible to receive tax benefits. NEB. REV. STAT. § 77-4104(4) (Employment and Investment Growth Act); NEB. REV. STAT. § 77-5723(5) (Nebraska Advantage Act); NEB. REV. STAT. § 77-27,187.02(4) (Nebraska Advantage Rural Development Act). There is no evidence in the record establishing that Bridgeport had entered into an agreement with the Tax Commissioner under any incentive program, and Bridgeport did not claim entitlement to a refund of sales or use taxes based on qualification under any tax incentive program. Accordingly, no statutory authority exists which would have allowed Bridgeport to appoint ICM as its purchasing agent, and any claim by Bridgeport that its contractual arrangement with ICM constitutes a purchasing agent appointment is rejected.

B. Bridgeport Does Not Qualify for the Manufacturing Machinery and Equipment Exemption Based on Purchases of Manufacturing Machinery and Equipment by ICM.

The Department's regulations provide: "Option 1 contractors will not collect sales tax on qualifying manufacturing machinery and equipment sold to a manufacturer regardless of whether the equipment remains tangible personal property or is annexed." 316 N.A.C. § 1.017.05F. Option 2 or Option 3 contractors, however, "must pay sales or use tax on all manufacturing machinery and equipment and any related repair or replacement parts they purchase and annex for a customer." 316 N.A.C. §§ 1.017.06F(1) and 1.017.07F(1). Bridgeport asserts the distinction drawn between Option 1 and Option 2 or 3 Contractors under these regulations is contrary to the statutes exempting manufacturing machinery and equipment from sales and use tax.

The court finds that Bridgeport's claim is erroneous, as it is based on an incorrect understanding of the scope of the manufacturing machinery and equipment exemption.

NEB. REV. STAT. § 77-2704.22 provides:

> (1) Sales and use taxes shall not be imposed on the gross receipts from the sale, lease, or rental and on the storage, use, or other consumption in this state of manufacturing machinery and equipment.
> (2) Sales and use taxes shall not be imposed on the gross receipts from the sale of installation, repair, and maintenance services performed on or with respect to manufacturing machinery and equipment.

"Manufacturing machinery and equipment" is defined as "any machinery or equipment purchased, leased, or rented by a person engaged in the business of manufacturing for use in manufacturing." NEB. REV. STAT. § 77-2701.47(1) (emphasis added). Thus, machinery and equipment used to manufacture tangible personal property must meet two criteria to be eligible for exemption: (1) The purchaser must be a person engaged in the business of manufacturing; and (2) the machinery and equipment must be used in manufacturing.[5]

"[S]tatutory language is to be given its plain and ordinary meaning in the absence of anything indicating to the contrary." *PSB Credit Services, Inc. v. Rich,* 251 Neb. 474, 477, 558 N.W.2d 295, 297 (1997). Further, Nebraska law requires that tax credits and exemptions be strictly construed. *First Data Corp. v. Nebraska Dep't of Revenue,* 263 Neb. 344, 352, 639 N.W.2d 898, 904 (2002). As tax exemptions are subject to the rule

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[5] The Nebraska Supreme Court has held that the exemption applies not only to purchases by a manufacturer of completed manufacturing machinery and equipment, but also to purchases of items assembled to make manufacturing machinery and equipment. *Concrete Indus. v. Nebraska Dep't of Revenue,* 277 Neb. 897, 766 N.W.2d 103 (2009).

of strict construction, "their operation will not be extended by construction." *Omaha Public Power Dist. v. Nebraska Dep't of Revenue,* 248 Neb. 518, 519, 537 N.W.2d 312, 314 (1995).

The plain language of § 77-2701.47(1), which defines the "manufacturing machinery and equipment" subject to exemption under § 77-2704.22(1), limits the exemption to manufacturing machinery or equipment purchased "by a person engaged in the business of manufacturing for use in manufacturing. . . ." Bridgeport mistakenly claims that the statute "exempt[s] all manufacturing equipment used in manufacturing." The exemption is not this broad, and is limited to the purchase of manufacturing machinery and equipment by manufacturers. The exemption must be strictly construed, and cannot be extended by construction. As an Option 3 contractor, ICM was the purchaser and consumer of all manufacturing machinery and equipment, or parts assembled to make such machinery and equipment, and thus was obligated to pay sales or use tax on all purchases of such machinery and equipment or parts. As ICM is not a "person engaged in the business of manufacturing," it was not eligible to claim the manufacturing machinery and equipment exemption, and Bridgeport cannot claim the exemption because it did not purchase such machinery and equipment or parts.

Bridgeport is incorrect in contending that the Department's regulations regarding the taxation of machinery and equipment or parts installed by contractors are contrary to the statutes granting the manufacturing machinery and equipment exemption. The regulations properly recognize that an Option 1 contractor is a retailer who is not the final consumer of building materials or other tangible personal property annexed to real estate and thus collects sales tax from its customers as purchasers. *See* NEB. REV.

STAT. § 77-2701.10(1); 316 N.A.C. § 1.017.02J. Because an Option 1 contractor acts as a retailer, a manufacturer may purchase manufacturing machinery and equipment (or parts assembled to make manufacturing machinery and equipment) from a contractor tax-free, as the manufacturer as purchaser qualifies for the exemption. 316 N.A.C. § 1.017.05F.

In contrast to Option 1 contractors, Option 2 and Option 3 contractors are considered to be consumers obligated to pay sales or use tax on building materials and other tangible personal property annexed to real estate "for all the purposes of the Nebraska Revenue Act of 1967." NEB. REV. STAT. § 77-2701.10(2) and (3). The only difference is that an Option 2 contractor must pay sales tax or remit use tax on building materials or other tangible personal property annexed to real estate when the items are purchased and received, maintaining a "tax-paid" inventory, 316 N.A.C. § 1.017.06C(2), while an Option 3 contractor maintains a "tax-free" inventory and must pay use tax at the time materials or other tangible personal property are withdrawn from inventory, 316 N.A.C. § 1.017.07C(2). In either case, an Option 2 or Option 3 contractor is the consumer and thus the purchaser obligated to pay sales or use tax on all manufacturing machinery and equipment (or parts assembled to make manufacturing machinery and equipment) installed for a customer, even though such machinery and equipment will ultimately be used by a manufacturer.

The Department's regulations are thus entirely consistent with the statutes granting the manufacturing machinery and equipment exemption, as only a manufacturer that purchases manufacturing machinery and equipment (or parts assembled to make such machinery or equipment) is entitled to the exemption. The

exemption is available to customers of Option 1 contractors, as in that case the contractor acts as a retailer who sells the manufacturing machinery and equipment or parts to the manufacturer as purchaser. In the case of Option 2 or 3 contractors, however, such contractors are not retailers, but consumers of such machinery and equipment (or parts), and, accordingly, the contractors are liable for all sales and use taxes on the purchase and use of such property. Because the Option 2 or 3 contractor is not a "person engaged in the business of manufacturing", the contractor cannot claim the manufacturing machinery and equipment exemption, as the exemption is available only to a manufacturer purchasing qualified manufacturing machinery and equipment for use in manufacturing.

"[T]he interpretation of a statute given by an administrative agency to which the statute is directed is entitled to weight." *Vulcraft v. Karnes,* 229 Neb. 676, 678, 428 N.W.2d 505, 507 (1988). "Agency regulations properly adopted and filed with the Secretary of State of Nebraska have the effect of statutory law." *Swift & Co. v. Nebraska Dep't of Revenue,* 278 Neb. 763, 767, 773 N.W.2d 381, 385 (2009). The Departments' regulations properly recognize the distinction between Option 1 contractors acting as retailers, and Option 2 and 3 contractors that are consumers, in determining eligibility for the manufacturing machinery and equipment exemption when contractors are engaged in the purchase and installation of manufacturing machinery and equipment. As ICM elected to be taxed as an Option 3 contractor, it was the consumer or purchaser of all manufacturing machinery or equipment (or parts assembled to make such machinery or equipment) at Bridgeport's ethanol plant. As Bridgeport did not purchase such property, the court finds that the Tax Commissioner

properly determined that Bridgeport could not claim entitlement to the manufacturing machinery and equipment exemption.

C. ICM's Purchase and Use of Building Materials or Manufacturing Machinery and Equipment or Parts Was Taxable Regardless of Whether the Property Was Real or Personal in Nature, as ICM, Not Bridgeport, Was in All Cases the Purchaser or User of the Property.

Bridgeport also erroneously contends that the Tax Commissioner's decision fails to distinguish between property annexed to real estate by ICM, and manufacturing machinery and equipment or parts purchased and used by ICM in construction of the ethanol plant which may constitute personal property. Regardless of whether the transactions involved building materials used by ICM and incorporated into real estate, or personal property in the nature of manufacturing machinery and equipment or parts purchased and used by ICM, Bridgeport is not entitled to any exemption based on ICM's purchase and use of any such property. In either case, ICM, not Bridgeport, was the purchaser or user of the property in question. *See* NEB. REV. STAT. § 77-2701.28 ("Purchase means any transfer of title or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means, of property for a consideration . . . ."). To the extent any transactions involved manufacturing machinery and equipment or parts deemed to be personal property, only purchases by a manufacturer are exempt, and, as Bridgeport was not the purchaser of any building materials or machinery and equipment used in the construction of the ethanol plant, it cannot claim any exemption from sales and use tax.[6]

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[6] Bridgeport's reference to the Nebraska Supreme Court's recent decision in *Vandenberg v. Butler County Bd. of Equal.*, 281 Neb. 437, 796 N.W.2d 580 (2011), is misplaced. *Vandenberg* involved the issue of whether the definition of "trade fixture" in

II. THE TAX COMMISSIONER'S PARTIAL DENIAL OF BRIDGEPORT'S CLAIM FOR REFUND OF SALES TAXES PAID BY BRIDGEPORT.

Bridgeport also sought a refund of $31,888.12 based on sales tax paid by Bridgeport. Bridgeport claimed these transactions involved purchases of property eligible for refund as exempt manufacturing machinery and equipment. The Tax Commissioner approved a refund of $6,324.84. The Tax Commissioner denied the remaining sales tax associated with this portion of the refund claim ($25,563,28), because it was determined, based on the information provided by Bridgeport, that the software and other equipment was not primarily used to:

- guide, control, operate, or measure the manufacturing process;
- produce, fabricate, assemble, process, finish, refine, or package the products produced; or
- maintain the integrity of the product, transport, convey, handle, or store the raw materials or products produced, or to measure the quality of the finished product.

Further, the Tax Commissioner disapproved the claim for refund of "tax paid on

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NEB. REV. STAT. § 77-105 (2009) included an irrigation pump. Section 77-105 defines "tangible personal property" for property tax purposes to include "trade fixtures, which means machinery and equipment, regardless of the degree of attachment to real property, used directly in commercial, manufacturing, or processing activities conducted on real property, regardless of whether real property is owned or leased." The Court in *Vandenberg* held that an irrigation pump is a trade fixture which should be taxed as personal property under the statute. The Court further held that "§ 77-105 clearly controls the issue of classifications of fixtures for taxation purposes. . .", and not the traditional three-part common law test applied in other contexts to determine whether an item is a fixture. 281 Neb. at 442, 796 N.W.2d at ___. *Vandenberg* has no application, as § 77-105 concerns the classification of "trade fixtures" as personal property for property tax purposes, and does not impact the application of the sales and use tax statutes. In any event, the classification of the transactions at issue in this case as involving building materials annexed to real estate, or personal property in the nature of manufacturing machinery and equipment or parts, is irrelevant, as, in either case, the transactions involved the purchase and use of property by ICM, not Bridgeport.

the purchase of consumable supplies, hand tools, and lab supplies," as "[s]uch items do not qualify for the manufacturing machinery and equipment exemption even though such items are expended during the manufacturing process."

Bridgeport asserts that "[t]he Department erred in failing to identify the items disapproved or the items approved." Brief of Appellant at 6. Bridgeport argues that "without some identification" of the items approved, "the decision cannot be tested," and that this "deprives the taxpayer of information on which to base an appeal." Brief of Appellant at 7.

"[T]o prevent evasion of the retail sales tax, it shall be presumed that all gross receipts are subject to the tax until the contrary is established." NEB. REV. STAT. § 77-2703(1)(f). Further, "[s]ince a statute conferring an exemption from taxation is strictly construed, one claiming an exemption from taxation of the claimant or the claimant's property must establish entitlement to the exemption." *Omaha Public Power Dist. v. Nebraska Dep't of Revenue,* 248 Neb. 518, 519, 537 N.W.2d 312, 314 (1995). Thus, there is a statutory presumption that all purchases by Bridgeport were subject to sales tax, and Bridgeport, as the party claiming an exemption from taxation, was required to establish entitlement to the exemption.

In support of its claim for refund of sales taxes paid on its direct purchases, Bridgeport relied on tax statements for the period from January 2008 through December 2008 showing the amount of sales taxes paid by Bridgeport, and vendor invoices for those transactions. The tax statements and invoices alone provided insufficient information for the Department to determine if these transactions involved the purchase of manufacturing machinery and equipment or parts which qualified for exemption. The

Department requested additional information from Bridgeport to assist in determining if these direct purchases qualified for exemption. Department staff reviewed the invoice detail provided by Bridgeport, and forwarded a spreadsheet with a list of invoices and requested a description of each item purchased. Based on this information, the Department created a spreadsheet identifying various items approved as exempt, and the record contains a listing of the invoice numbers and a description of items which the Department determined were eligible for refund in the amount of $6,324.84.

Contrary to Bridgeport's assertion, the record does reflect the items for which the Tax Commissioner allowed a refund on the portion of the refund claim based on direct purchases by Bridgeport. The court finds that Bridgeport is thus incorrect in arguing that an absence of identification deprives it of the ability to "test" the Department's decision or present its arguments on appeal.

More importantly, Bridgeport's position fails to acknowledge that it is not the Department's burden to prove that Bridgeport was not entitled to the exemption. All the transactions at issue were presumed to be taxable, and Bridgeport was required to establish its entitlement to the exemption. The invoices provided by Bridgeport gave no indication whether any of the underlying purchases involved manufacturing machinery and equipment (or parts) which qualified for exemption. It was only the Department's efforts to request and review additional information from Bridgeport which enabled the Department to make a determination of the transactions that qualified for exemption. The Department prepared an itemized list of the transactions and amounts allowed, and Bridgeport has pointed to no record evidence which establishes those determinations were erroneous. As to the remainder of the claim, Bridgeport cites no evidence which

supports the allowance of an exemption for those transactions. As it was Bridgeport's burden to establish entitlement to the exemption claimed, the court finds the Tax Commissioner's allowance of the refund claim in the amount of $6,324.84 was proper, and that the Tax Commissioner did not err in denying the remainder of Bridgeport's claim based on direct purchases.

CONCLUSION

IT IS THEREFORE ORDERED, ADJUDGED, AND DECREED that the Tax Commissioner's final decision allowing Bridgeport's refund claim in the amount of $6,324.84, and denying the remainder of the refund claim, is affirmed. Costs of this action are taxed to Appellant Bridgeport.

Dated: September 30, 2011.

BY THE COURT:

John A. Colborn
District Judge

cc: William E. Peters, Attorney for Plaintiff
L. Jay Bartel, Attorney for Defendant